83-342
No.

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

ROBERT H. WALDSCHMIDT, TRUSTEE
Cross-Petitioner,
v.
RANIER & ASSOCIATES, HARRY H. RANIER, ALGIN H. NOLAN, LIBERTY NATIONAL LEASING COMPANY, AND FIRST SECURITY NATIONAL BANK OF LEXINGTON,
Cross-Respondents.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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ISSUE PRESENTED

Whether a purported sale of substantially all of the assets of a corporation to its sole shareholder, whereby the corporation suffers a detriment and the sole shareholder receives a benefit, and where the sale is not documented to provide third parties with notice of the transaction, is valid as against the Trustee in Bankruptcy for the corporation, under the principles outlined by the Supreme Court in the case of *Pepper v. Litton*, 308 U.S. 295, 60 S. Ct. 238 (1939).

PARTIES

The Cross-Petitioner is the Trustee in Bankruptcy for Fulghum Construction Corporation, a debtor under the Bankruptcy Reform Act of 1978. Ranier & Associates is a partnership consisting of Harry H. Ranier and Algin H. Nolan, which owns 100% of the stock in Fulghum Construction Corporation. Liberty National Leasing Company and First Security National Bank of Lexington are financial institutions which advanced money to the sole shareholder, Ranier & Associates, and obtained security documents from the sole shareholder pertaining to the construction equipment which is the subject of this petition.

The Cross-Petitioner may be referred to in this pleading as "Trustee". Harry H. Ranier, Algin H. Nolan, and Ranier & Associates may be referred to collectively as "Ranier & Associates". Liberty National Leasing Company and First Security National Bank of Lexington may be referred to collectively as "Banks". The debtor, Fulghum Construction Corporation, may be referred to as "Fulghum".

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CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Robert H. Waldschmidt, as Trustee in Bankruptcy for the estate of Fulghum Construction Corporation, cross-petitions for a writ of certiorari to review the decision of the United States Court of Appeals for the Sixth Circuit in this case relative to the affirmation of the ruling of the United States District Court for the Middle District of Tennessee concerning to the validity of the sale of certain construction equipment. The cross-respondents, Ranier & Associates, Harry H. Ranier, and Algin H. Nolan have previously filed a petition for writ of certiorari relative to the issue of certain preferential transfers. (No. 83-193)

Cross-Petitioner was served with copies of the Petition for Writ of Certiorari on August 5, 1983.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 706 F.2d 171 and is reproduced in the Appendix, *infra*, pp. 1a-8a. (The Court of Appeals did not discuss the Trustee's allegations concerning the sale of construction equipment, but adopted the rationale as set forth in the District Court's memorandum opinion.) The opinion of the United States District Court for the Middle District of Tennessee is reported at 7 Bankr. 629 and is reproduced in the Appendix, *infra*, pp. 11a-35a. The opinion of the United States Bankruptcy Court for the Middle District of Tennessee is reported at 14 Bankr. 293 and is reproduced in the Appendix, *infra*, pp. 37a-56a.

JURISDICTION

The judgment of the United States Court of Appeals for the Sixth Circuit was entered on May 9, 1983. The jurisdiction of this court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS FOR REVIEW

Whether an alleged transaction which occurred on September 20, 1978, which was not documented by the corporation, unauthorized by the corporation, detrimental to the corporation, and beneficial to the sole shareholder/purchaser is valid, considering the provisions of the Uniform Commercial Code, the Texas Business Corporation Act, and the equitable principles pronounced by the United States Supreme Court in the case of *Pepper v. Litton*, 308 U.S. 295, 60 S. Ct. 238, 84 L.Ed. 281 (1939).

STATUTORY PROVISIONS

The applicable provision of § 541 of the Bankruptcy Reform Act of 1978 provides as follows:

§ 541. Property of the estate.

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such

estate is comprised of all of the following property, wherever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of this case. . . .

The applicable provision of § 544 of the Bankruptcy Reform Act of 1978 provides as follows:

11 U.S.C. § 544(b) provides:

The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

The applicable provisions of the Uniform Commercial Code, as adopted by the state of Texas, provide as follows:

Tex. Code Ann. Bus. & Comm. § 2.402(b) provides:

A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

Tex Code Ann. Bus. & Comm. § 2.401(3) provides:

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods:

(a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or

(b) if the goods are at the time of contracting already identified and no documents are to

be delivered, title passes at the time and place of contracting.

STATEMENT OF THE CASE

This proceeding presents a situation where the sole shareholder of a corporation abused its position, and, through self-dealing with the corporation, has attempted to deprive the creditors of the corporation of any distribution from assets which belong to the bankrupt estate.

Fulghum Construction Corporation was placed into involuntary bankruptcy by the filing of a petition on January 25, 1980. The Cross-Petitioner was appointed trustee by order of the Court dated February 5, 1980, and filed this adversary proceeding on February 6 in order to ascertain the respective rights of the debtor and its sole shareholder, Ranier & Associates, with respect to certain construction equipment which was in the possession of the debtor at the time the petition was filed.

An amended complaint was filed on April 16, 1980 to include First Security National Bank of Lexington and Liberty National Leasing Company as Defendants, said financial institutions having asserted an interest in the construction equipment as secured creditors of the sole shareholder, Ranier & Associates.

Subsequent to a hearing on this matter on May 23 and 24, 1980, the United States Bankruptcy Court for the Middle District of Tennessee entered a partial judgment on July 14, 1980 ruling that the trustee had no interest in the equipment.

The trustee appealed to the District Court which affirmed the decision of the Bankruptcy Court by order entered September 18, 1981. (App. pp. 11a-36a.) The United States Court of Appeals for the Sixth Circuit affirmed this issue by judgment dated May 9, 1983.

The United States Bankruptcy Court, in its memorandum of July 14, 1980, set forth certain findings of

fact with respect to this proceeding. (App. pp. 38a-43a.) The United States District Court adopted these findings of fact in its memorandum. (App. pp. 12a-17a.) The United States Court of Appeals for the Sixth Circuit affirmed the holding of the Courts below without comment on the facts of the case. (App. p. 8a).

Fulghum Construction Corporation was a Texas corporation, formed in 1966, involved in the construction of oil and natural gas pipelines. Its principal place of business was Lavergne, Tennessee.

Prior to October, 1977, the corporation was owned by James T. Fulghum and J. B. Miller, who also managed the operation of the business. In October, 1977, Harry H. Ranier and Neale R. Hall purchased the stock of the corporation from Mr. Fulghum and Mr. Miller, under the premise that they would inject needed capital into the corporation. In July of 1978, Neale R. Hall transferred his stock to Harry H. Ranier, and a partnership was formed between Mr. Ranier and Algin H. Nolan, under the name of Ranier & Associates. Ranier & Associates has continued as the corporation's sole shareholder since July of 1978.

Immediately prior to September 20, 1978, Fulghum Construction Corporation owned certain heavy construction equipment, which was used in the operation of its business, valued at over one million ($1,000,000.00) dollars. On September 20, 1978, Mr. Nolan entered into a transaction with the corporation, wherein the corporation acknowledged receipt of $1,137,350.00 from Ranier & Associates and Ranier & Associates agreed to lease the corporation's equipment to the corporation.

> The sale agreement contained no language of conveyance. Neither the shareholder nor the corporation took any formal steps to consummate the sale. No bill of sale was ever executed, and none of the documents evidencing ownership of the equipment

> (*e.g.*, files maintained by the corporation on each item of equipment that included the original bill of sale and other pertinent documents) were ever transferred from the corporation to the shareholder. Several items of equipment were covered by certificates of title issued by the State of Tennessee. None of the title certificates were ever transferred to the shareholder. The corporation remained in possession of all of the equipment. (App. pp. 14a, 40a, 41a.)

Fulghum Construction Corporation retained all documentation concerning the title to the equipment, and continued to apply and pay for the tags and licensing of said vehicles after September 20, 1978.

In order to make this capital contribution, Ranier & Associates borrowed $950,000.00 from Liberty National Leasing Company. The balance of the payment, $187,-350.00, was transferred to Fulghum but was immediately withdrawn and returned to Ranier & Associates.

> Nolan testified at the trial that the $187,350.00 was withdrawn from the corporation's account in order to safeguard it against a possible unauthorized withdrawal. He indicated that Mr. Fulghum had made such a withdrawal some months before. Mr. Fulghum, however, had been dismissed more than two months earlier. The Court thus finds that Nolan's explanation of the withdrawal was patently false. It is apparent that the shareholder had no intention of paying the full cash purchase price in September, 1978 but intended only to advance to the corporation the proceeds of the Liberty National loan. (App. pp. 15a, 41a.)

Furthermore, the $950,000.00 received by the corporation did not provide the corporation with the operating capital it needed. The majority of the funds were used to satisfy an existing lien on the equipment, thus negating any benefits the corporation might have obtained through this transaction.

Although third parties dealing with Fulghum perceived no change in the asset structure of the corporation, Ranier & Associates chose to treat this transaction as a sale-leaseback arrangement. However, as noted by the Courts below, such a transaction benefited only the sole shareholder.

> While the transaction resulted in an improvement in the corporation's balance sheet and liquidity, it was detrimental to the corporation in that it resulted in a significant taxable gain and necessitated the dissipation of a valuable asset—the tax loss carry forward —to avoid payment of substantial tax liability that resulted. The real beneficiary appears to have been the shareholder, which was able to depreciate the equipment from the new stepped-up basis. (App. pp. 16a, 42a.)

Any sale of the corporation's equipment would not have been a prudent action on the part of the corporation.

The involvement of Liberty National Leasing Company and First Security National Bank of Lexington results from a security interest which was granted to them by Ranier & Associates subsequent to the transaction of September 20, 1978. Fulghum did not execute any of these documents. These security interests were perfected in the State of Kentucky on the basis that Ranier & Associates was the owner of the equipment. (App. pp. 16a, 17a, 42a, 43a.) However, neither of these banks made any attempts to insure that the equipment was actually owned by Ranier & Associates.

Subsequent to the transaction of September 20, 1978, which eroded the bulk of the assets of Fulghum Construction Corporation, the capital requirements of the corporation remained unsatisfied. When the company obtained several construction contracts shortly after September, 1978, funding of these projects was supplied directly by Ranier & Associates in the form of short-term transfers to the corporation.

> It was the shareholder's practice to withdraw from the corporation, as well as other corporations it owned, any cash that was not immediately required by the corporation and to return it on an as needed basis. (App. pp. 16a, 42a.)

Thus, the sole shareholder, after attempting to strip the corporation of virtually all of its assets, only contributed sufficient funds to the corporation to cover its payables, and even these funds were withdrawn as the cash became available.

During the last year of the operation of the business approximately one hundred (100) additional transactions occurred involving transfers between Ranier & Associates and Fulghum Construction Corporation, involving amounts in excess of $1,300,000.00 The transfers between these entities (or the commingling of the assets) were never documented by the corporation or Ranier & Associates as loans or capital contributions, and there were no corporation resolutions authorizing this activity by Ranier & Associates.

Fulghum Construction Corporation was insolvent at all times while these transactions between Ranier & Associates and the corporation were continuing. (App. pp. 4a, 27a.)

RULINGS OF THE COURTS BELOW

The Trustee filed this proceeding seeking a determination that the construction equipment was property of the bankrupt estate and that the attemtped sale was void. Other allegations in the complaint sought the piercing of the corporate veil and avoidance of certain preferential transfers.

Under 11 U.S.C. § 541, property of the estates is defined as including "all legal or equitable interests of the debtor in property." The Trustee, being the representative of the estate, asserted that Fulghum Construction Corporation never transferred its equipment to Ranier &

Associates in September, 1978, and thus these assets were property of the estate pursuant to § 541. In addition, pursuant to 11 U.S.C. § 544(b), the Trustee asserted that a creditor could have pursued an action to determine the validity of attempted transfers of assets, and hence the Trustee could also contest the transfer.

Under the terms of U.C.C. 2-402, as adopted in Texas, the sale in question is a nullity, and the equipment thus "sold" properly belongs in the bankrupt estate of Fulghum Construction Corporation. Tex. Code Ann. Bus. & Comm. § 2-402(b). *See Bevard v. Ajax Mfg. Co.*, 473 F. Supp. 35, 38 (E.D. Mich. 1979).

Retention of personal property by the seller after the sale is evidence of fraud in each state where the equipment may have been situated at the time of the sale. *Edwards v. Dickson*, 66 TX 613, 25 S.W. 718 (1886); *Hewgley v. General Motors Acceptance Corporation*, 286 S.W. 2d 355 (Tenn. App. 1956); *Bullard v. Nattin*, 137 So. 551 (La. App. 1931); *Primeaux* v. *Hinds*, 350 So. 2d 1310 (La. App. 1977); *In Re Hardwick & Magee Co.*, 11 U.C.C. Rptr. 1172 (E.D. Pa. 1972).

Fulghum Construction Corporation remained in possession of the construction equipment, maintained possession of the documents of title, and continued to pay for the licensing and maintenance of the assets All incidents of ownership remained with Fulghum. The Trustee thus asserted that the provisions of U.C.C. § 2-402(b) are applicable to the purported sale of assets from Fulghum Construction Corporation to Ranier & Associates, and the transaction is void.

The District Court concluded that title to the goods passed under U.C.C. § 2-401(3), and thus a valid sale of the equipment took place.

In the United States Court of Appeals, the Trustee argued that this was a misapplication of U.C.C. § 2-401, the

entire purpose of which is to determine when title passes from seller to buyer in disputes *between those two parties*. The official comments make it clear that the section is intended to deal only with issues between buyer and seller and should not affect the rights of third parties as provided in other sections of the Article.[1] Thus, while § 2-401 (c) might have been germane to a dispute between Fulghum and Ranier, it has no application to the case at bar, and the question of whether a valid sale took place as to creditors is more properly controlled by 2-402(b). The United States Court of Appeals did not address this argument in affirming the decisions of the Courts below.

The Trustee then asserted that Tex. Bus. Corp. Act Ann. § 510 (Vernon) mandates that any corporation that wishes to dispose of all or substantially all of its assets must obtain stockholder approval through a vote of the stockholders. The language is not permissive; it is mandatory. *McDonald v. First National Bank of Attleboro*, 70 F.2d 69 (1st Cir. 1934). It is uncontroverted that Fulghum disregarded this requirement by failing to hold stockholder meetings or obtain corporate resolutions.

The Courts below relied upon the apparent intent of Ranier & Associates as shareholders of Fulghum Construction Corporation, and imputed that intent of said transferee to the corporation/transferor. The District Court further ignored the interests of the creditors of the corporation by finding that, where there are no minority

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1 Comment to Tex. Code Ann. Bus. & Com. § 2.401 provides:

> This Article [Chapter] deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article [Chapter] is made clear by the preamble of this section.

shareholders, there is no need for strict compliance with the act. (App. p. 20a.)

The Trustee finally argued that Ranier & Associates breached its fiduciary duty to the creditors of the corporation by attempting this self-dealing transaction, in accordance with the principles set forth by the Supreme Court in *Pepper v. Litton*, 308 U.S. 295, 60 S. Ct. 238, 84 L. Ed. 281 (1939). Although the District Court acknowledged that the transaction should be viewed with strict scrutiny, it ignored the factual finding that the transaction was detrimental to the corporation, and dismissed the Trustee's complaint. (App. pp. 20a, 21a.)

REASONS FOR ALLOWANCE OF WRIT

The decision of the United States Court of Appeals for the Sixth Circuit, in affirming the holding of the United States District Court for the Middle District of Tennessee with respect to the attempted transfer of the construction equipment to the sole shareholder, contradicts the equitable principles set forth by the Supreme Court in the case of *Pepper v. Litton*, 308 U.S. 295, 60 St. Ct. 238, 84 L. Ed. 281 (1939). *Pepper v. Litton* also involved a situation in which the sole shareholder of a corporation used his position of control in the corporation to delay, hinder, and frustrate the attempts of one creditor to satisfy its obligation. In that case, the sole shareholder revived certain salary claims which had been dormant for years for the primary purpose of obtaining priority over a creditor. The court held that:

> **A director is a fiduciary. *Twin-Lick Oil Co. v. Marbury*, 91 U.S. 487, 588. So is a dominant or controlling stockholder or group of stockholders. *Southern Pacific Co. v. Bogert*, 250 U.S. 483, 492. Their powers are powers in trust. See *Jackson v. Ludeling*, 21 Wall. 616, 624. Their dealing with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the cor-**

> poration is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 599. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside. While normally that fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, it is, in the event of bankruptcy of the corporation, enforceable by the trustee. For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation creditors as well as stockholders. 308 U.S. at 294.

It is the obligation of a shareholder and director to act with the utmost good faith in the best interests of a corporation and its creditors, and a shareholder must refrain from exploiting his strategic position for his own personal profit to the detriment of the corporation and its creditors.

The obligation of a controlling shareholder or director to avoid self-dealing with the corporation is also adopted by the decisions in the State of Texas, where Fulghum Construction Corporation was incorporated. *Texas Society, D.A.R. v. Fort Bend Chapter*, 590 S.W. 2d 156 (Tex. Civ. App. 1979); *Tigrett v. Pointer*, 580 S.W. 2d 375 (Tex. Civ. App. 1978); *Crook v. Williams Drug Company, Inc.*, 558 S.W. 2d 500 (Tex. Civ. App. 1977); *See Canion v. Texas Cycle Supply, Inc.*, 537 S.W. 2d 570 (Tex. Civ. App. 1976); *Dowdle v. Texas American Oil Company*, 503 S.W. 2d 647 (Tex. Civ. App. 1973); *Reynolds-Southwestern Corp. v. Dresser Ind., Inc.*, 438 S.W. 2d 135 (Tex. Civ. App. 1969). Thus, both under applicable state law, and under holdings in the United

States Supreme Court, a shareholder cannot transact business with its own corporation, whereby a shareholder benefits to the detriment of the corporation, or equity will remedy the result.

Ranier & Associates was the sole shareholder of Fulghum Construction Corporation and as such had a fiduciary obligation to the creditors of Fulghum. By entering into an agreement which, if declared valid, would permit the shareholder to gain a benefit at the expense and detriment of the corporation, Ranier & Associates has breached its fiduciary duty to the corporation and its creditors. Furthermore, this transaction was not properly authorized or documented by the corporation, as required under applicable state statutes. Such self-dealing should not be permitted under the equitable doctrine as set forth in *Pepper v. Litton, supra.* Therefore, in order to prevent Ranier & Associates from realizing its impermissible goal, this Court should declare the purported sale void, thereby permitting the equipment to be included in the debtor's estate to be administered for the benefit of those creditors which Ranier & Associates sought to undermine.

CONCLUSION

The United States Sixth Circuit Court of Appeals, by affirming the decision of the United States District Court, decided the issue concerning the ownership of the equipment in a way which is in conflict with the applicable decisions of the Supreme Court, as set forth in the case of *Pepper v. Litton, supra.* Furthermore, the decision so far departs from the accepted and usual course of judicial proceedings in adopting equitable principles, that the Supreme Court should exercise its powers of supervision to remedy the wrong which has been created through the self-dealing actions of the sole shareholder, Ranier & Associates. Therefore, the Trustee in Bankruptcy for Fulghum Construction Corporation requests that his cross-petition for a review on writ of certiorari be granted,

and that title to the construction equipment in question be established in the bankrupt estate.

Respectfully submitted,

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APPENDIX

APPENDIX

RECOMMENDED FOR FULL-TEXT PUBLICATION

See, Sixth Circuit Rule 24

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Nos. 81-5779, 81-5801

IN RE: FULGHUM CONSTRUCTION CORPORATION,
Debtor,

ROBERT WALDSCHMIDT, TRUSTEE,
Plaintiff-Appellant,
Cross-Appellee,

v.

HARRY RANIER, ALGIN NOLAN and RANIER & ASSOCIATES,
Defendants-Appellees,
Cross-Appellants,

FIRST SECURITY NATIONAL BANK OF LEXINGTON and
LIBERTY NATIONAL LEASING COMPANY,
Defendants-Appellees.

On Appeal from the United States District Court
for the Middle District of Tennessee

Decided and Filed May 9, 1983

Before: CONTIE and KRUPANSKY, Circuit Judges; and CELEBREZZE, Senior Circuit Judge.

KRUPANSKY, J. This action joins inquiry into the long-standing judicially evolved application of the "net result rule" as the criteria for determining a preferential transfer as defined in 11 U.S.C. § 547 of the Bankruptcy Reform Act of 1978. An involuntary petition in bankruptcy was filed against Fulghum Construction Corporation (Fulghum) whereupon the trustee initiated the instant proceeding to, *inter alia*, avoid as preferential transfers certain monetary transactions which transpired between Fulghum and its sole shareholder, Ranier & Associates (Ranier), during the one year period immediately preceding the filing of the bankruptcy petition. Both the bankruptcy court and reviewing district court adjudged that application of the net result rule, incorporated into 11 U.S.C. § 547(b)(5) as a judicial gloss, foreclosed a finding that the transfers were preferential. *See*: *In re Fulghum Construction Corp.*, 7 B.R. 629 (Bankr. M.D Tenn. 1980); *In re Fulghum Construction Corp.*, 14 B.R. 293 (M.D. Tenn. 1981). The operative facts, detailed in the lower courts' opinions, disclose that approximately 100 transactions occurred between Ranier and Fulghum during the year immediately preceding the filing of the bankruptcy petition. The aggregate amount of the payments by Ranier to Fulghum exceeded the aggregate amount of the payments tendered by Fulgham to Rainer during this period and the value of the estate was accordingly appreciated.

Preferential transfers which may be avoided by the trustee are defined in 11 U.S.C. § 547(b):

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owned by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—

(i) was an insider; and

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provision of this title.

As is facially evident from this provision, all five enumerated criteria must be satisfied before a trustee may avoid any transfer of property as a preference. *See*: *In re Bishop*, 17 B.R. 180, 181-82 (Bankr. N.D. Ga. 1982). Section 547(b) is proscribed by its own terms to the numerous "defenses" available to creditors which appear in § 547(c) and which, if applicable, preclude the trustee from avoiding the § 547(b) preferential transfer. Particularly, § 547(c)(4) provides:

(c) The trustee may not avoid under this section a transfer—

* * * *

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor

> gave new value to or for the benefit of the debtor—
>
> > (A) not secured by an otherwise unavoidable security interest; and
> >
> > (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor

Section 547(c)(4) is perhaps most accurately characterized as a "subsequent advance rule". Preferential transfers as defined in § 547(b) may not be avoided by the trustee if "*after* such transfer, such creditor gave new value". *Id. See*: *In re Bishop, supra*; *In re Garland*, 19 B.R. 920 (Bankr. E.D. Mo. 1982); *In re Rustia*, 20 B.R. 131, 135 (Bankr. S.D. N.Y. 1982); *In re Fabric Buys of Jericho*, 22 B.R. 1013, 1016-17 (Bankr. S.D. N.Y. 1982); *In re Hersman*, 20 B.R. 569 (Bankr. N.D. Ohio 1982).

In the action *sub judice*, the district court adjudged, and the parties do not dispute on appeal, that the criteria of § 547(b)(1) through (b)(4) have been satisfied. In addressing the application of § 547(b)(5) to the facts of the case at bar, however, the district court relied upon its equitable powers to justify its application of the net result with the following rationale:

> [T]his Court must agree with the Bankruptcy Court that two "net result rules" actually exist in bankruptcy law. One, that of section 547(c)(4) and insisted upon by the trustee, is statutory. The other, that applied by the Bankruptcy Court, is nonstatutory, a judicial gloss upon the requirements of section 547(b).

14 B.R. at 303. Applying the net result rule as a condition implicitly incorporated into § 547(b)(5) and, correspondingly, a threshold requirement to support a pref-

erential transfer, the district court observed that the net effect of all the transactions between the debtor, Fulghum, and the creditor, Ranier, appreciated the value of the estate and, accordingly, the transfers could not be avoided by the trustee as preferences. Upon concluding that no preferential transfers existed it was unnecessary for the district court to identify the defenses available to the creditor under § 547(c).

The net result rule is a judicially created doctrine, predicated upon principles of equity, which evolved shortly after the enactment of the Bankruptcy Act of 1898 to presumably rectify what was judicially perceived to be inequities in bankruptcy law. *See: In re Garland, supra,* 19 B.R. at 922-25 (artfully documenting development of this doctrine); *In re Bishop supra,* 17 B.R. at 183-85 (same). As an equitable doctrine its application, of necessity, must "comport to and remain compatable with the prevailing legislative intent". *In re Bell,* 700 F.2d 1053, 1057 (6th Cir. 1983); *United States* v. *Killoren,* 119 F.2d 364, 366 (8th Cir. 1941). Logic dictates that judicial interposition of the net result rule into § 547(b)(5) vitiates the congressional intent clearly reflected both on the face of § 547 and in the legislative history of the enactment.

Since the net result rule is "broader" in scope than the subsequent advance rule of § 547(c)(4), engrafting the former doctrine upon § 547(b)(5) as a threshold requirement for the qualifying preference would render the defense incorporated in § 547(c)(4) impotent. The broader scope of the net result rule permits its utilization by the creditor irrespective of whether the value furnished by the creditor to the debtor is advanced either before or after the transfer from the debtor to the creditor. Contrawise, the subsequent advance rule of § 547(c)(4) is more circumscribed in application and forecloses avoidance of the transfer by the trustee only if the creditor provides additional value *after* the transfer from the

debtor to the creditor.[1] A "judicial gloss" which significantly restricts the statutory definition of "preference" and pragmatically emasculates the creditor defense thereto as intended by Congress in § 547(c)(4) constitutes nothing less than legislation by judicial decree.

Moreover, judicial interposition of the net result rule into § 547(b)(5) finds no sanction in the legislative history of the Bankruptcy Reform Act of 1978. The legislative proceedings attendant to the promulgation of § 547(b)(5) are significantly devoid of any allusion to the net result rule. Contrawise, the House Report discussing the subsequent advance rule, § 547(c)(4), incorporates concise language reflecting the intent of Congress:

> The fourth exception [§ 547(c)(4)] codifies the net result rule in section 60c of current law. If the creditor and the debtor have more than one exchange during the 90-day period, the exchanges are *netted out according to the formula in paragraph (4).* Any new value that the creditor advances must be unsecured in order for it to qualify under this exception. (Emphasis added).

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 374, reprinted in 1978 U.S. Code. & Ad. News 5787, 6330. The Senate Report is identical. S. Rep. No. 95-989, 95th Cong., 2d Sess. 88, reprinted in 1978 U.S. Code Cong. & Ad. News. 5874. Thus, it would appear that the "net result rule" is an anachronism of § 547(c). As has been noted.

> Whatever the net result rule may have been under the prior Bankruptcy Act, Congress has indicated

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[1] Bankruptcy Judge Robert Bauer appears to have recognized this dilemma:

> I can think of no set of facts where, if the net result rule were to be applied under section 547(b)(5), 547(c)(4) would ever be utilized.

In re Garland, supra, 19 B.R. at 926.

> that, under the Bankruptcy Code, the rule is to be applied accordingly to the formula set forth in section 547(c)(4).

In re Garland, supra, 19 B.R. at 926. Congressional metamorphasis has transformed the judicially created net result rule into what may be characterized as a subsequent advance rule and has codified this augmented version into § 547(c)(4) rather than § 547(b)(5). *See also: In re Bishop, supra,* referencing: 2 *Norton Bankr. L. & Prac.* § 32.20 (net result rule "is of doubtful current validity"); 4 *Collier on Bankruptcy* § 547.40 (seriously questioning continuing validity of the net result rule in the wake of the Bankruptcy Reform Act of 1978); Report of the Commission on the Bankruptcy Laws of the United States, H.Doc.No. 93-137, 93rd Cong., 1st Sess., Pt. 1, 210-211 (1973) ("A true 'net result' rule would total all payments and all advances and offset the one against the other. This is not allowed under the Commission's recommendation, since the advance to be offset must be subsequent to the preference.")

Section 547(b) deliberately defines a preference as a "transfer", rather than as an aggregate of transfers or netting of transactions between the creditor and debtor, and § 547(c) artfully articulates equitable "defenses" whereby the trustee may be foreclosed from avoiding the preference. In particular, § 547(c)(4) permits a netting procedure to be applied when the debtor and creditor are both recipients and initiators of transactions. Construed *in pari materia,* § 547(b) and (c) disclose a calculated legislative scheme and intent to implement equitable considerations which the judiciary at the turn of this century adjudged as lacking and responded by evolving the net result rule. This legislative response reflected in the promulgation of § 547(b) and particularly § 547(c)(4) mirror the congressional version of equitable principles, expressed as the subsequent advance rule, to be incorporated into the 1978 revision of the Bankruptcy Act.

Accordingly, the judgment of the district court dismissing the trustee's complaint to avoid transfers from Fulghum to Ranier as preferential is hereby VACATED and this case is REMANDED for further proceedings consistent with this opinion. The judgment of the district court is AFFIRMED in all other respects, including the dismissal of (1) the trustee's amended complaint seeking to set aside the sale of construction equipment, and seeking to pierce Fulghum's corporate veil and (2) Ranier's claim for damages arising from the trustee's alleged improper retention of construction equipment, for the reasons articulated in the district court's memorandum opinion.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Nos. 81-5779, 81-5801

IN RE: FULGHUM CONSTRUCTION CORPORATION,
Debtor,

ROBERT H. WALDSCHMIDT, TRUSTEE,
Plaintiff-Appellant,
Cross-Appellee.

v.

HARRY RANIER, ALGIN NOLAN and RANIER & ASSOCIATES,
Defendants-Appellees,
Cross-Appellants,

FIRST SECURITY NATIONAL BANK OF LEXINGTON and
LIBERTY NATIONAL LEASING COMPANY,
Defendants-Appellees.

Before: CONTIE and KRUPANSKY, Circuit Judges, and CELEBREZZE, Senior Circuit Judge.

JUDGMENT

On appeal from the United States District Court for the Middle District of Tennessee

THIS CAUSE came on to be heard on the record from the said District Court and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the judgment of the said District Court dismissing the trustee's complaint to avoid transfers from Fulghum to Ranier as

preferential is hereby vacated and the case is remanded for further proceedings consistent with the opinion of this Court. The judgment of the District Court is affirmed in all other respects.

Each party to bear its own costs on this appeal.

ENTERED BY ORDER OF THE COURT

JOHN P. HEHMAN, Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

No. 81-3040

IN RE: FULGHUM CONSTRUCTION CORPORATION,

MEMORANDUM

This action is an appeal by the bankruptcy trustee from two judgments entered by the United States Bankruptcy Court, *In re Fulghum Construction Co.*, 7 B.R. 629 (Bkcy. Ct. M.D. Tenn. 1980) and *In re Fulghum Construction Co.*, No. 380-00235, Adv. Proc. No. 380-0081 (Bkcy. Ct. M.D. Tenn. July 14, 1980), Hon. Russell H. Hippe, Jr., presiding, dismissing the trustee's complaint in the proceeding below. Also involved in this action is an appeal by defendant Ranier & Associates from the dismissal of a counterclaim for damages filed by it against the trustee.

In this appeal the trustee argues that the Bankruptcy Court erred in its conclusions (1) that the trustee had no interest in certain equipment sold by the debtor, Fulghum Construction Company, to one of the defendants, Ranier & Associates; (2) that the corporate entity should not be disregarded and therefore that defendant Ranier & Associates—the sole shareholder of the debtor—should not be held liable for the debtor's debts; and (3) that certain payments made by the debtor to defendant Ranier & Associates were not preferential transfers under section 547(b) of the Bankruptcy Code. Ranier & Associates in turn challenges the conclusion of the Bankruptcy Court that it failed to substantiate its claim for

damages that it allegedly suffered because of the trustee's retention of the above-mentioned equipment.

For the reasons stated in this opinion, the appeals of both parties are dismissed and the judgment of the Bankruptcy Court is affirmed in all respects.

Applicable Law

The Bankruptcy Court found that the law of Texas, the state of debtor's incorporation, was controlling on the issues of whether the corporate veil should be pierced and whether the transfer of the equipment from the debtor to Ranier & Associates was a valid sale. This finding is not disputed, and this Court agrees that Texas law is applicable. *See* Restatement (Second) of Conflicts § 302 (1971).

Facts

The Bankruptcy Court made the following findings of fact in the proceeding below. Because these findings are not clearly erroneous, they are adopted by this Court and herein repeated. *See* Rule 810, Rules of Bankruptcy Procedure.

> 1. The corporation was organized in Houston, Texas, in 1966. It was named Fulghum Engineering & Construction, Inc., for one of its organizers, James T. Fulghum, who served as the corporation's president. The name was later changed to Fulghum Construction Corporation.
>
> 2. The corporation was authorized to engage in a wide variety of heavy construction activities but at all times material hereto engaged principally in the construction of oil and natural gas pipelines. It was authorized to do business in some thirty states and Canada. At all times material hereto its principal place of business was in the vacinity [sic] of Nashville, Tennessee.

3. In October 1977, Harry H. Ranier and Neale R. Hall, residents of Kentucky, acquired all of the outstanding shares of stock in the corporation. Although Ranier and Hall became vice-presidents of the corporation, no significant changes in management were made at that time. Mr. Fulghum, who continued to serve as president, testified that it was his understanding that the new owners were going to infuse the corporation with additional capital, because substantial liquid assets were required for such companies to bid successfully on large projects.

4. The corporation lost in excess of $600,000 from its operations during 1977.

5. In the early part of 1978, Ranier formed a general partnership with a certified public accountant, Algin H. Nolan, known as Ranier & Associates. Since July of that year, when Hall transferred all of his stock to Ranier, Ranier & Associates has been the corporation's sole shareholder.

6. The shareholder expressed dissatisfaction with the management of the corporation at a meeting in April 1978. On July 15, 1978, Mr. Fulghum and another key member of the management team were discharged. Both the shareholder and the directors adopted resolutions authorizing Nolan

> to assume full and complete management and administrative responsibilities of the Corporation with full power to remove and/or replace any and all personnel thereof, to reorganize in any fashion or cease altogether any or all operaations of the Corporation, including dissolutionment, as he in his sole discretion may deem necessary, proper, or expedient.

A few days later a new board of directors elected Michael J. Leatherman executive vice-president to assume responsibility for soliciting bids for the cor-

poration and for overseeing the company's operations. These were the last significant formal actions taken by the shareholder or the directors of the corporation prior to the filing of the trustee's complaint.

7. The first steps taken by Nolan pursuant to the extraordinary powers granted him in the shareholder's and directors' resultions occurred in September 1978. For the stated purpose of improving both the balance sheet and the liquidity of the corporation, he decided that all of the corporation's equipment should be sold to the shareholder and then be leased back to the corporation. The equipment was appraised at $1,137,350. To effect this sale and leaseback, two uncaptioned agreements were executed by the shareholder and the corporation on or about September 20, 1978. One of the agreements recited that the shareholder as buyer had paid to the corporation as seller of the equipment the cash purchase price of $1,137,350. In the other, the shareholder purported to lease the equipment back to the corporation. The sale agreement contained no language of conveyance. Neither the shareholder nor the corporation took any formal steps to consummate the sale. No bill of sale was ever executed, and none of the documents evidencing ownership of the equipment (*e.g.*, files maintained by the corporation on each item of equipment that included the original bill of sale and other pertinent documents) were ever transferred from the corporation to the shareholder. Several items of equipment were covered by certificates of title issued by the state of Tennessee. None of the title certificates were ever transferred to the shareholder. The corporation remained in possession of all of the equipment.

8. Although the so-called sale agreement recited that the corporation received $1,137,350 in cash, that recitation was false. The shareholder obtained a loan

in the amount of $950,000 from one of the defendants, Liberty National Leasing Company (as subsidiary of Liberty National Bank), to finance the major portion of the purchase price and initially only paid this sum to the corporation. Coincidental with this transaction, Nolan transferred the corporation's principal bank accounts from a Nashville bank to one in Mt. Sterling, Kentucky, where Ranier & Associates had its office. Apparently a check in the amount of $1,137,350 was deposited in one of the corporation's newly opened accounts. On the same date, however, a check drawn on that account in the amount of the difference between the Liberty National loan and the purchase price—$185,350—was deposited in one of the shareholder's accounts. These checks apparently were paid on the same date. Thus only $950,000 was actually paid to the corporation in September 1978.

9. Nolan testified at the trial that the $185,350 was withdrawn from the corporation's account in order to safeguard it against a possible unauthorized withdrawal. He indicated that Mr. Fulghum had made such a withdrawal some months before. Mr. Fulghum, however, had been dismissed more than two months earlier. The court thus finds that Nolan's explanation of the withdrawal was patently false. It is apparent that the shareholder had no intention of paying the full cash purchase price in September 1978 but intended only to advance to the corporation the proceeds of the Liberty National loan.

10. A corporate balance sheet prepared by an accounting firm immediately after the September 1978 transaction reflected a shareholder's equity of $170,-928.00. Prior to the purported sale, the equipment was carried on the corporation's books at the depreciated value of $436,258.00. Thereafter the corporation never represented in its financial records that it continued to own the equipment.

11. While the transaction resulted in an improvement in the corporation's balance sheet and liquidity, it was detrimental to the corporation in that it resulted in a significant taxable gain and necessitated the dissipation of a valuable asset—the tax loss carry-forward—to avoid payment of the substantial tax liability that resulted. The real beneficiary appears to have been the shareholder, which was able to depreciate the equipment from the new, stepped-up basis. While the loan proceeds provided the corporation with additional cash, there was no showing why the corporation itself could not have borrowed this amount of money, using the equipment as collateral as the shareholder did.

12. The shareholder granted Liberty National a security interest in the equipment to secure repayment of this loan.

13. According to a detailed analysis prepared by Nolan, a substantial number of financial transactions between the corporation and the shareholder took place between June 1978 and November 1979. It was the shareholder's practice to withdraw from the corporation, as well as other corporations it owned, any cash that was not immediately required by the corporation and return it on an as-needed basis. According to this analysis, which was never seriously questioned by the trustee, there were almost one hundred such transactions during this period of time. Initially the corporation was indebted to the shareholder, but as a result of the $187,350 credit from the equipment transaction, the shareholder became indebted to the corporation and remained so until June 1979. From that time until the corporation ceased doing business in November 1979, the corporation was indebted to the shareholder for advances made to it. The net result is that the corporation presently is indebted to the shareholder in the

sum of $387,844.16. Most of the advances made by the shareholder in the latter part of 1979 were in the form of deposits to the corporation's payroll account at the Kentucky bank to ensure completion of jobs in progress.

14. Although there were a substantial number of financial transactions between the shareholder and the corporation, it appears that Nolan, who rigidly controlled the corporation's finances at least after September 1978 maintained detailed records separating the financial affairs of the partnership and the corporation.

15. In May 1979 the shareholder borrowed substantial sums of money from another of the defendants, First Security National Bank of Lexington. As part of the security therefor, Ranier & Associates granted the bank a security interest in the equipment. It is conceded by the trustee that the sums owed to both secured party defendants substantially exceed the present value of the equipment and that, if their security interests are valid, he has no interest in the equipment.

16. On January 25, 1980, an involuntary petition was filed against the corporation in this court, and an order for relief subsequently was entered.

The Sale of the Equipment

The trustee challenges the validity of the equipment transfer from Fulghum Construction Company to Ranier & Associates on two grounds. First, the trustee argues that because of certain improprieties in the sales transaction itself, title to the equipment never passed to Ranier & Associates. Alternatively, the trustee argues that even if title passed, the sale should be set aside as fraudulent. This Court rejects both these contentions and agrees with the Bankruptcy Court that title to the equipment passed

to Ranier & Associates upon full payment of the purchase price.

The trustee's initial argument is that title to the equipment did not pass because no formal bill of sale was ever executed and no actual transfer of the certificates of title to certain pieces of the equipment occured. This argument must fail for the simple reason that the failure to transfer these documents does not prevent transfer of the title itself. As the Bankruptcy Court correctly ruled, the transaction in question here is governed by section 2-401(3)(b) of the Uniform Commercial Code, which has been adopted by all three states concerned here (Texas, Tennessee, and Kentucky). That provision states:

> Each provision of this chapter with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this chapter and matters concerning title become material the following rules apply:
>
> (3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods:
>
>> (b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

The pertinent case law under this section demonstrates clearly that the crucial consideration in determining passage of title is not the transfer of a certificate of title but the completion of all performance intended to occur by the parties to the contract. *See Young v. Golden State Bank*, 560 P.2d 855 (Colo. App. 1977); *Ace Supply, Inc. v. Rocky-Mountain Machinery Co.*, 525 P.2d 965 (Idaho 1974); *Southwest Bank v. Moritz*, 23 Neb. 45 (1979). *See also Wood Chevrolet Co., Inc. v. Bank of*

Southeast, 352 So.2d 1350 (Ala. 1977); *International Harvester Credit Corp. v. Associates Financial Services Co., Inc.*, 211 S.E.2d 430 (Ga. 1974); *Seigel v. Giant Food, Inc.*, 318 A.2d 874 (Md. App. 1974); *National Exchange Bank v. Mann*, 260 N.W.2d 716 (Wis. 1978). Clearly, the parties in this case intended that title to the equipment would pass upon payment of the purchase price. Once Ranier & Associates paid the outstanding amount of that price, it acquired title to the equipment. Moreover, after the final payment was made, the equipment was no longer listed as an asset by Fulghum Construction Company on its records. Instead, Ranier & Associates listed the equipment as its assets and proceeded to lease the equipment to Fulghum. It is irrelevant that Ranier & Associates did not take physical possession of the equipment because no such transfer of physical possession was intended by the parties to occur. Additionally, contrary to the trustee's contention, it is unimportant that the Tennessee motor vehicle statute, T.C.A. § 55-3-118, may state that a certificate of title must be transferred to transfer the title itself. Nondelivery of a certificate of title does not prevent the effective passage of title from the seller to the buyer under section 2-401, even when a state's certificate of title act provides that no title can be acquired until the certificate has been issued or delivered. *See, e.g., Wood Chevrolet Co., Inc. v. Bank of Southeast*, 352 So.2d 1350 (Ala. 1977). Section 2-401 governs such transactions, and the title passes without the need for a formal certificate or other document indicating transfer of title.

As this Court concludes that title to the equipment did pass to Ranier & Associates, the trustee would have this Court declare the transaction void as fraudulent. The trustee presents two bases for his position: (1) there was no formal vote of approval of the sale by the shareholders of Fulghum Construction Company, and (2) the sale was allegedly in breach of a fiduciary duty owed by Ranier & Associates to the creditors of Fulghum Con-

struction Company. In support of his initial argument the trustee relies upon the Texas Business Corporation Act, which states in relevant part that any sale of "all or substantially all" of a corporation's assets must be authorized by a formal vote of the corporation's shareholders. The trustee argues that because Ranier & Associates was not in literal compliance with that provision, the sale of equipment is void.

To accept the trustee's position would be to defy common sense. Ranier & Associates was the only shareholder of Fulghum Construction Company, and it was Ranier & Associates who authorized and carried out the equipment sales transaction. The Bankruptcy Court noted correctly that the purpose of the consent provision of the Texas Act, like other similar statutes, is to protect the interests of minority shareholders. Because no minority shareholders exist in this case, it would serve no purpose to require Ranier & Associates to comply strictly with the Act. To be in compliance under the trustee's theory, Ranier & Associates would have had to vote a recommendation of the transaction, give notice to itself of the recommendation and of a meeting to vote on the recommendation, and then at the meeting vote approval of the deal. Clearly, as the Bankruptcy Court concluded, bringing about this sort of charade was not the intent of the Act.

The trustee's second contention has greater merit than his statutory argument, but it too must fail. The trustee argues that Ranier & Associates breached a fiduciary duty to the creditors of Fulghum Construction Company in authorizing and performing the sale of equipment. This Court agrees with the trustee that the controlling shareholder—and in this case the sole shareholder—of a corporation maintains a fiduciary obligation to not only the minority shareholders but also the creditors of the corporation. *See Pepper v. Litton,* 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939). This Court also agrees with

the trustee that a transaction between a controlling shareholder and a corporation, such as the one in question here, is to be given a higher degree of scrutiny than other contracts. *See* 13 W. Fletcher, Cyclopedia of the Law of Private Corporations §§ 5834, 5837 (rev. ed. 1970). Examining the equipment sale transaction with even this higher degree of scrutiny, however, this Court still concludes that Ranier & Associates did not breach its duty to the creditors.

The trustee argues that by selling the equipment Ranier & Associates deprived Fulghum Construction Company of valuable assets that would have enabled the company to secure capital under supposedly better conditions than the outright sale provided. This argument is not supported by the facts. Fulghum Construction Company was in dire financial condition at the time Ranier & Associates acquired it. Because of its poor financial position the company was in need of a large infusion of capital. A feasible approach to secure this capital was to have Ranier & Associates acquire financing for the company, and this it did by granting to the defendant lending institutions a security interest in the equipment. Although Ranier & Associates did gain some benefit from the sale, the facts are simply not sufficient to support a finding that the end result was so detrimental to the company that Ranier & Associates somehow breached its fiduciary obligation to either the company or the company's creditors.

For the above reasons, this Court agrees with the Bankruptcy Court that the trustee has no interest in the equipment. The conclusion of the Bankruptcy Court is affirmed.

Disregarding the Corporate Entity

The trustee appeals from the ruling of the Bankruptcy Court that the corporate entity of Fulghum Construction Company should not be disregarded and therefore that the defendant Ranier & Associates is not liable for the company's debts. For the reasons stated below, this Court

rejects the trustee's effort and affirms the Bankruptcy Court's decision.

As the Bankruptcy Court correctly related, under Texas law the corporate entity should be disregarded only as an extraordinary remedy under extreme conditions. The corporate veil has been pierced only in such dire cases as when the corporate fiction has been utilized to defraud existing creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate a monopoly, or to protect the commission of crimes. *See Pace Corp. v. Jackson*, 284 S.W.2d 340 (Tex. 1955); *Roylex, Inc. v. Langson Bros. Construction Co.*, 585 S.W.2d 768 (Tex. Civ. App. 1979); *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. 1979); *Tigrett v. Pointer*, 580 S.W.2d 375 (Tex. Civ. App. 1978); *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App. 1978); *Holmes v. Clow*, 533 S.W.2d 99 (Tex. Civ. App. 1976); *Minchen v. Van Trease*, 425 S.W.2d 435 (Tex. Civ. App. 1968); *Radio KBUY, Inc. v. Lieurance*, 390 S.W.2d 16 (Tex. Civ. App. 1965). From an examination of the facts set forth previously, it is apparent that none of these conditions exist in this case.

The Texas courts have established a two-part test to determine whether the corporate entity should be disregarded. First, the complaining party must demonstrate fraud and a lack of good faith on the part of the controlling shareholder. *Roylex, Inc. v. Langson Bros. Construction Co.*, 585 S.W.2d 768 (Tex. Civ. App. 1979); *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. 1979); *Hanson Southwest Corp. v. Dal-Mac Construction Co.*, 554 S.W.2d 712 (Tex. Civ. App. 1977); *Holmes v. Clow*, 533 S.W.2d 99 (Tex. Civ. App. 1976); *Radio KBUY, Inc. v. Lieurance*, 390 S.W.2d 16 (Tex. Civ. App 1965). Second, the complaining party must show a degree of stockholder control that the corporation retains no separate corporate interests of its own. *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App. 1978); *Hanson Southwest Corp. v. Dal-Mac Construction Co.*, 554 S.W.2d 712 (Tex. Civ. App. 1977);

Simon v. Estate of Allen, 497 S.W.2d 800 (Tex. Civ. App. 1973), *cert. denied*, 419 U.S. 843, 95 S.Ct. 76, 41 L.Ed.2d 71 (1974). The trustee has failed to show that either of these factors exist.

One indication of fraud and bad faith on the part of the controlling shareholder is corporate capitalization that is very small in relation to the nature of the corporation's business and to the risks that the business necessarily entails. *Arnold v. Phillips (In re Southern Brewing Co.)*, 117 F.2d 497 (5th Cir.), *cert. denied*, 313 U.S. 583, 61 S.Ct. 1102, 85 L.Ed.2d 1539 (1941). For fraud and bad faith to be found, however, the inadequate capitalization must exist at the time of incorporation. *Moore & Moore Drilling Co. v. White*, 345 S.W.2d 550 (Tex. Civ. App. 1961). Such was clearly not true in this case. Although Fulghum Construction Company was acutely underfinanced at all times after Ranier & Associates purchased its stock in 1977, it was not so at the time of its inception.

Additionally, the Texas courts have set forth a number of factors to determine whether the requisite degree of shareholder control exists to warrant piercing the corporate veil. These include:

(1) commencement of business without the issuance of shares;

(2) a lack of shareholder or directors' meetings or of the signing of consents;

(3) the making of decisions by shareholders as if they were partners;

(4) a failure to distinguish between corporate property and personal property;

(5) the use of corporate funds to pay personal expenses without proper accounting; and

(6) a failure to maintain complete and separate corporate and financial records.

Roylex, Inc. v. Langson Bros. Construction Co., 585 S.W. 2d 768, 772 (Tex. Civ. App. 1979). None of these factors are applicable in this case. Moreover, as the Bankruptcy Court correctly stated,

> Evidence of informality or a commingling of shareholder and corporate affairs [such as occurred here], however, alone is insufficient to justify disregarding the corporate entity in the absence of bad faith on the part of the controlling shareholder or prejudice to third parties. . . . There must be a showing that the individual who controls the corporation and manages its business affairs does so in such a manner that individual or corporate creditors may be deprived of their legal rights by a shuffling of the legal personalities of the corporation and its controller to the extent that the corporation is, in fact, the alter ego of the controller or that the corporate formalities were not adhered to by the corporation in connection with the matters in question. *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. 1979).

No. 380-00235 at 12. Although Ranier & Associates and Fulghum Construction Company might not at all times have kept the ideal degree of separation between themselves, it cannot be said that the shareholder so dominated the company or that the company's creditors were so prejudiced to justify disregarding the corporate entity. This Court agrees with the Bankruptcy Court that

> [a]ll of the proof indicates that all of the funds advanced to Fulghum in whatever form during 1978 and 1979 were intended to rehabilitate the company and to keep it solvent. . . . The actions taken by Ranier & Associates after their purchase of Fulghum in 1977—the termination of the company's old management and the hiring of a new executive vice-president, the exercise by Nolan of complete control over the company's financial affairs, the transfer of

> the company's bank accounts to the Mt. Sterling bank, and the advances by Ranier & Associates during 1979 to meet Fulghum's payroll—are more indicative of an intent on the part of Ranier & Associates to rehabilitate the company than an intent by the shareholder to use the corporate shell for its own purposes.

No. 380-00235 at 14. As the Bankruptcy Court also correctly noted, simply having a unity of financial interest between the shareholder and company does not warrant piercing the veil, nor does the fact that the shareholder puts money into the corporation. *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App. 1978). There must also be some indication of bad faith or fraud on the part of the controlling shareholder. Even utilizing the "holistic" approach urged by the trustee and considering all the facts together, this Court must conclude that the trustee has not shown that such bad faith or fraud exists. *See Cupples Coiled Pipe, Inc. v. Esco Supply Co.*, 591 S.W.2d 615 (Tex. Civ. App. 1979).

The conclusion of the Bankruptcy Court is thus affirmed.

The Net-Result Rule

The trustee also seeks to have this Court overturn the ruling of the Bankruptcy Court with regard to the series of financial transactions that occurred between the debtor and the shareholder during the months of June through November 1979. Because these transactions left the debtor in debt to the shareholder in the amount of $387,844.16, the Bankruptcy Court ruled that the payments made by the debtor to the shareholder did not constitute preferential transfers under section 547(b) of the Bankruptcy Code and were therefore not voidable by the trustee. The trustee argues that this finding is erroneous and that all of the payments made by the debtor are preferences within the meaning of section 547(b) and therefore fully voidable by the trustee. The trustee also argues that even

if the shareholder is allowed to set off against these preferences the advances that it made to the debtor, certain of the debtor's payments, totalling approximately $394,400, are still nonetheless voidable and recoverable by the trustee. This Court agrees with the Bankruptcy Court that the payments were not preferences within the meaning of section 547(b) and are therefore not voidable by the trustee.

At the heart of this dispute is the applicability of the so-called "net result" rule to the facts of this case. The central issue is whether the net result rule is operative under section 547(b) in the determination of whether a preferential transfer has actually been made or whether the rule exists only under section 547(c)(4) and applies only after a preference has already been determined to exist to enable a creditor to balance out certain transactions with the debtor.

Section 547(b) of the Bankruptcy Code sets forth the components of a preference. That section states:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition, or
>
> (B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—
>
> (i) was an insider; and

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The Bankruptcy Court found as fact that the shareholder was a creditor of the debtor, that the payments made by the debtor to the shareholder were for or on account of an antecedent debt, that the debtor was insolvent at the time the payments were made, and that the shareholder—an "insider"—knew that the debtor was insolvent. Because these findings are not clearly erroneous, they are accepted by this Court. *See* Rule 810, Rules of Bankruptcy Procedure. Thus, the payments by the debtor clearly satisfy the requirements of subsections (1)-(4) of section 547. The dispute in this case, then, is over whether the payments also satisfy the final requirement of section 547(b)(5), which states in relevant part that to be a preference a payment must "enable . . . such creditor to receive more than such creditor would receive if . . . the transfer had not been made. . . ."

As the Bankruptcy Court stated, the test for determining whether the requirement of section 547(b)(5) has been met is "whether the creditor obtained from the debtor's property a greater percentage of his debt than some other creditor would have received under the distributive provisions of the Code had the transfer not occurred." 7 B.R. at 639. 4 Collier, Bankruptcy ¶ 547.35 (15th ed. 1980). The Bankruptcy Court also stated that

> [w]hether a creditor has received a preference under the [Bankruptcy] Act was determined not by what the situation would have been if the debtor's assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, but by the *actual effect* of the payment as determined when bankruptcy results.

Id. In applying the above-stated test, then, the Bankruptcy Court employed a "net result" approach. Under this approach the Bankruptcy Court examined whether the net effect of all the transactions between the debtor and the shareholder was actually to deplete the debtor's estate and thereby interfere with an equal distribution of the debtor's assets among creditors or whether the net effect was to increase the debtor's estate and thereby benefit all the creditors. Because the net result of the transactions was to increase the debtor's estate, in that the shareholder received $387,844.16 more than it received in return, the Bankruptcy Court ruled that the section 547(b)(5) requirement had not been met. The Bankruptcy Court thus held that the payments were not voidable transfers under section 547(b).

In appealing the Bankruptcy Court's decision to this Court, the trustee argues that the Bankruptcy Court misapplied—and misunderstood—the net result rule. The trustee argues that the net result rule has nothing whatsoever to do with section 547(b). Instead, the trustee argues, the net result rule is a defense of sorts that a creditor may raise under section 547(c)(4) only *after* a preferential transfer has been found to have been made under section 547(b). Under the trustee's interpretation, then, the net result rule does not preclude the existence of a preference, but rather, only immunizes certain preferential payments from avoidance by the trustee, provided the transfers meet the specifications of section 547(c)(4). The trustee criticizes the Bankruptcy Court for, in his words, "injecting" the net result rule into section 547(b)(5).

The trustee has offered a number of arguments in support of his position, but this Court concludes that it must respectfully reject them all. Rather than there being only one net result rule—embodied in section 547(c)(4) as the trustee urges—this Court must agree with the Bankruptcy Court that two "net result rules" actually exist in bankruptcy law. One, that of section 547(c)(4) and insisted upon by the trustee, is statutory. The other, that applied by the Bankruptcy Court, is nonstatutory, a judicial gloss upon the requirements of section 547(b).

The Bankruptcy Court's thorough review of the relevant case law indicates clearly that over the years the courts have utilized a net result approach under section 60a of the old Bankruptcy Act, the predecessor to section 547(b), as well as under section 60c of the Act, the predecessor to section 547(c)(4). *See Joseph Wild & Co. v. Provident Life & Trust Co.*, 214 U.S. 292, 29 S.Ct. 619, 53 L.Ed. 1003 (1909); *Yaple v. Dahl-Millikan Grocery Co.*, 193 U.S. 526, 24 S.Ct. 552, 48 L.Ed. 776 (1904); *Jaquith v. Alden*, 189 U.S. 78, 23 S.Ct. 649, 47 L.E. 717 (1903); *Federal International Banking Co. v. Childs (In re Fred Stern & Co.)*, 54 F.2d 478 (2d Cir. 1931); *Mills v. J.H. Fisher & Co.*, 159 F. 897 (6th Cir. 1908). *See also In re Sagor & Brother*, 9 Am. Bkcy. Rptr. 361 (2d Cir. 1903); *Gans v. Ellison*, 114 F. 734 (3d Cir. 1902); *Kimball v. E.A. Rosenham Co.*, 114 F. 85 (8th Cir. 1902); *Dickson v. Wyman*, 111 F. 726 (1st Cir. 1901). Commentary on the old Act also confirms use of the net result rule under section 60a:

> The net result rule developed in the days when preferences were voidable even though there was no knowledge or reasonable cause to believe insolvency of the debtor. It provided that if there is a running account of credit and payment, the entire transactions over the 4 months are examined and if more credits than payments occurred even though individual payments during the period might comprise a

> preference, there is no preference. That is, if the net result enriches the estate there is no preference. Indications are that the rule would apply partially. That is, a transfer was only preferential to the extent that transfers exceeded credits to the debtor.

2 Cowans, Bankruptcy Law and Practice § 474 (2d ed. 1978) (citations omitted).

The rationale for application of the net result rule to the determination of preferences under section 60a was stated cogently by the Second Circuit in *Federal International Banking Co. v. Childs (In re Fred Stern & Co.)*, 54 F.2d 478 (2d Cir. 1931):

> It is unjust to hold that, because the appellee has in the ordinary course of business during the four months preceding bankruptcy received payments which, under similar circumstances, might operate as a preference in some views of the law, it will bar the proof of this claim when, looking at all the transactions together, they demonstrate they were without any intention to acquire or to give any unjust preferences, and particularly where they have increased the net indebtedness to the creditor and effected a corresponding increase of the bankrupt's estate. . . . In order to avoid such an unreasonable result, it is proper to hold that all the transactions covered by this account will be regarded as one, so that it may not be held that the effect of any of the payments was to enable the appellee to obtain a greater percentage of its debt than any other creditor of the same class, within the meaning of the Bankruptcy Act. . . . The test in determining the absence or existence of a preference is whether or not the entire course of dealings on the open account, resulting from this revolving credit, resulted in the enrichment of the insolvent estate.

54 F.2d at 480. Clearly, in the case before this Court, the overall result of the transactions between the debtor and

the shareholder was to enrich the estate of the debtor by nearly $400,000. To adopt the position urged by the trustee that the debtor's payments to the creditor were preferences potentially voidable by the trustee would be to bring about exactly the sort of "unjust" and "unreasonable" result opposed by *Sterns* and the other decisions cited above. This Court thus agrees with the Bankruptcy Court that the net result rule has not been limited to section 60c. The net result rule is properly applicable under section 60a—now section 547(b)(5)—and seems well suited to use in this particular case.

Before this Court can say conclusively, however, that the payments made by the debtor to the shareholder in this case are not preferences, one other issue must be addressed: whether the shareholder's knowledge of the debtor's insolvency precludes application of the net result rule in this particular case. This Court agrees with the Bankruptcy Court that it does not.

The trustee argues that the decisions of those courts applying the net result rule in any respect have predicated their conclusions on the creditor's ignorance of the debtor's bankrupt status. In other words, the trustee argues that any knowledge by a creditor of a debtor's precarious financial situation prevents application of the net result rule to the transactions between them. In support of his contention, the trustee relies upon several decisions that have in fact stated that the net result rule is inapplicable under such circumstances. *See Cooper Petroleum Co. v. Hart*, 379 F.2d 777 (5th Cir. 1967); *Campanella v. Liebowitz (In re Peter Cassinelli Macaroni Co.)*, 103 F.2d 252 (3d Cir. 1939); *In re Grocers' Baking Co.*, 266 F. 900 (M.D. & N.D. Ala. 1920), *aff'd sub nom. Eagleston v. Birmingham Trust & Savings Co.*, 277 F. 1015 (5th Cir. 1921); *In re Farmer's Store & Supply Co.*, 214 F. 505 (N.D. Wa. 1914). The trustee relies in particular on *Cooper Petroleum v. Hart*, 379 F.2d 777 (5th Cir. 1967), in which the Fifth Circuit ruled that the net

result rule was inapplicable when a creditor knows or has sufficient reason to know that the debtor is insolvent at the time the transactions take place. The Fifth Circuit based its decision to a great extent on its conclusion that

> the Supreme Court decisions in which the rule arose as well as subsequent cases relying upon those decisions appear to have placed much more emphasis upon the creditor's lack of knowledge of the debtor's insolvency to justify application of the rule than upon any rationalization as to enrichment of the debtor's estate.

379 F.2d at 780.

While the cases cited by the trustee are strong support for his position, there are, as the Bankruptcy Court noted, several decisions in which a creditor's knowledge of the debtor's insolvency did not affect application of the net result rule. *See Farmers Bank v. Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021, 88 S.Ct. 593, 10 L.Ed.2d 662 (1967); *Wilson v. Kanter (In re Marley-Morse Co.)*, 275 F. 832 (7th Cir. 1921); *In re Stewart*, 233 F. Supp. 89 (D. Or. 1964). The thrust of these decisions is not only that the enrichment of the debtor's estate is far more important than the creditor's knowledge of the debtor's financial status in determining the applicability of the rule, but also that strong policy considerations make the creditor's knowledge irrelevant. As the court in *In re Stewart* declared, to deny application of the net result rule simply because the creditor is aware of the debtor's condition

> would create chaos in that vast area of business relationships where the creditor has knowledge of the debtor's difficulty, but desires to assist in solving the problems by going along with the debtor on an arrangement similar to [the one presented here] . . . . [A] plan such as that, time after time, assists the debtor in putting his house in order, paying all

> creditors and making a success of his own venture. To treat such a transaction as a preference within the meaning of the bankruptcy act would be nothing short of placing a premium, or a brand of approval, on the actions of those creditors who do not attempt to assist the debtor, but on the other hand attach the property and thus force the debtor out of business.

233 F. Supp. at 92.

The Bankruptcy Court was persuaded by the force and logic of these latter decisions and ruled that the shareholder's knowledge of the debtor's insolvency in this case did not preclude applying the net result rule here. This Court believes that the Bankruptcy Court's conclusion is correct. Having reviewed the Supreme Court's decision in *Joseph Wild*, *Yaple*, and *Jaquith*, this Court does not agree with the conclusion of the Fifth Circuit in *Cooper Petroleum* or the position of the trustee in this case that those decisions depended on the knowledge, or lack thereof, of the creditor. In fact, from a close reading of the three decisions, it is difficult to discern any support in the opinions for the proposition that the creditor's knowledge was in any way determinative of the results reached by the Court. Although the creditor's lack of knowledge of the debtor's insolvency was posed by counsel as one component of one question for review in *Yaple*, the Court summarily applied the net result rule to the facts of that case and in no way indicated that the issue of knowledge was influential in its decision. 193 U.S. at 527, 24 S.Ct. at——, 48 L.Ed. at 776. Indeed, in *Joseph Wild*, the Court declared that *Yaple* stood for the specific principle that

> where a creditor has a claim upon an open account for goods sold and delivered during the period of four months before the adjudication in bankruptcy, the account being made up of debits and credits, leaving a net amount due from the bankrupt estate,

> . . . payments made under such circumstances [do] not constitute preferences . . . .

214 U.S. at 297, 29 S.Ct. at ——, 53 L.Ed. at 1004. No mention is made of the creditor's knowledge or lack of knowledge.

As is apparent, disagreement exists among the courts regarding the question of a creditor's knowledge of insolvency. In the absence of any clear weight of authority on either side of this issue, this Court believes that the better rule of law is that a creditor's knowledge does not preclude application of the net result rule to determine the existence or nonexistence of preferential transfers under section 547(b) of the Bankruptcy Code. In addition to agreeing with the extremely persuasive policy argument articulated by the court in *In re Stewart*, this Court concurs with the position of the Bankruptcy Court that requiring ignorance of insolvency would be inconsistent not only with the requirements of section 60a, as it existed, but also with the requirements of the present section 547(b) with regard to both insiders and others. *See* 7 B.R. at 647. Moreover, this Court agrees with the Bankruptcy Court that such a knowledge factor

> would be inconsistent with the fundamental purpose for the voidable preference provisions of the Code, which is not the imposition of a penalty upon creditors preferred by the debtor, but the equitable distribution of the debtor's assets among all creditors.

Id. Application of the net result rule to the present case ensures that the goal of equitable distribution will be met.

As a final point with regard to this issue, the trustee argues that even if the net result rule is applicable, the shareholder must have made each advance after a payment by the debtor in order to escape avoidance. Under this argument, the shareholder would be entitled to set off $837,000 of the advances made by it to the debtor, while being required to return approximately $394,400 in payments. This latter sum is the amount that the trustee

alleges that payments by the debtor exceeded subsequent advances by the shareholder after July 27, 1979. The Court respectfully rejects this argument. Even if the transactions between the shareholder and the debtor could be dichotomized by the July 27 date—a notion upon which this Court declines to comment—the trustee's argument is irrelevant because it is based upon a reading of the set-off provision of section 547(c)(4). *See* 2 Cowans, Bankruptcy Law and Practice § 474 (2d ed. 1978). Since section 547(c) is never called into play unless a preference is found to exist and since this Court agrees with the Bankruptcy Court that the payments made by the debtor here were not preferences, the trustee's argument must fail as moot. This Court offers no opinion about the validity of the argument in a case in which preferential transfers are found to exist.

For all of the foregoing reasons, this Court agrees with the Bankruptcy Court that the payments here in question were not to any extent preferences under section 547 of the Bankruptcy Code. The conclusion of the Bankruptcy Court is affirmed.

Ranier & Associate's Counterclaim

The last issue to be resolved in this case is the counterclaim by Ranier & Associates against the trustee for damages allegedly incurred because of the trustee's detention of the above-discussed equipment during the initial stages of the bankruptcy procedure. Although Ranier & Associates asserts that it suffered $354,764 in damages, which sum it alleges it could have acquired by renting out the equipment, the Bankruptcy Court found that Ranier & Associates offered no proof that such damage actually was suffered. This Court agrees with the Bankruptcy Court that no proof of any damage suffered by Ranier & Associates because of the trustee's actions exist in the record. Accordingly, this Court concludes that the Bankruptcy Court acted correctly in dismissing the counterclaim.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE,
NASHVILLE DIVISION

No. 81-3040

IN RE: FULGHUM CONSTRUCTION CORPORATION

ORDER

In accordance with the accompanying Memorandum, the judgments of the Bankruptcy Court are hereby affirmed. The appeals of the bankruptcy trustee and Ranier & Associates are dismissed.

/s/ Thomas Wiseman
THOMAS WISEMAN
United States District Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE

Case No. 380-00235

Adv. Proc. No. 380-0081

IN RE: FULGHUM CONSTRUCTION COMPANY,
Debtor

ROBERT H. WALDSCHMIDT, TRUSTEE,
Plaintiff

vs.

HARRY H. RANIER, ALGIN H. NOLAN,
RANIER & ASSOCIATES, EGAN IRON WORKS
FIRST SECURITY NATIONAL BANK OF LEXINGTON, and
LIBERTY NATIONAL LEASING COMPANY,
Defendants

MEMORANDUM

APPEARANCES:

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RUSSEL H. HIPPE, JR.
Bankruptcy Judge

In this adversary proceeding the trustee of a debtor corporation, which engaged in the pipeline construction business, seeks relief from its sole shareholder, asserting principally (1) that the separate existence of the corporation should be disregarded and the shareholder held liable for all corporate debts; (2) that the transfer of all of the corporation's equipment to the shareholder in September 1978 was never consummated or, in the alternative, was fraudulent and should be set aside; and (3) that the transfers of certain funds from the corporation to the shareholder were preferential payments on antecedent debts that should be avoided pursuant to 11 U.S.C. § 547 (1979). Incidental to the relief sought from the shareholder, the trustee attacks the validity of security interests in the equipment granted by the shareholder to the two secured party defendants.

Findigs of fact and conclusions of law pursuant to Rule 752, Federal Rules of Bankruptcy Procedure, follow.

I. FINDINGS OF FACT

1. The corporation was organized in Houston, Texas, in 1966. It was named Fulghum Engineering & Con-

struction, Inc., for one of its organizers, James T. Fulghum, who served as the corporation's president. The name was later changed to Fulghum Construction Corporation.

2. The corporation was authorized to engage in a wide variety of heavy construction activities but at all times material hereto engaged principally in the construction of oil and natural gas pipelines. It was authorized to do business in some thirty states and Canada. At all times material hereto its principal place of business was in the vicinity of Nashville, Tennessee.

3. In October 1977, Harry H. Ranier and Neale R. Hall, residents of Kentucky, acquired all of the outstanding shares of stock in the corporation. Although Ranier and Hall became vice-presidents of the corporation, no significant changes in management were made at that time. Mr. Fulghum, who continued to serve as president, testified that it was his understanding that the new owners were going to infuse the corporation with additional capital, because substantial liquid assets were required for such companies to bid successfully on large projects.

4. The corporation lost in excess of $600,000 from its operations during 1977.

5. In the early part of 1978, Ranier formed a general partnership with a certified public accountant, Algin H. Nolan, known as Ranier & Associates. Since July of that year, when Hall transferred all of his stock to Ranier, Ranier & Associates has been the corporation's sole shareholder.

6. The shareholder expressed dissatisfaction with the management of the corporation at a meeting in April 1978. On July 15, 1978, Mr. Fulghum and another key member of the management team were discharged. Both the shareholder and the directors adopted resolutions authorizing Noland

> to assume full and complete management and administrative responsibilities of the Corporation with full power to remove and/or replace any and all personnel thereof, to reorganize in any fashion or cease altogether any or all operations of the Corporation, including dissolutionment, as he in his sole discretion may deem necessary, proper, or expedient.

A few days later a new board of directors elected Michael J. Leatherman executive vice-president to assume responsibility for soliciting bids for the corporation and for overseeing the company's operations. There were the last significant formal actions taken by the shareholder or the directors of the corporation prior to the filing of the trustee's complaint.

7. The first steps taken by Nolan pursuant to the extraordinary powers granted him in the shareholder's and directors' resolutions occurred in September 1978. For the stated purpose of improving both the balance sheet and the liquidity of the corporation, he decided that all of the corporation's equipment should be sold to the shareholder and then be leased back to the corporation. The equipment was appraised at $1,137,350. To effect this sale and leaseback, two uncaptioned agreements were executed by the shareholder and the corporation on or about September 20, 1978. One of the agreements recited that the shareholder as buyer had paid to the corporation as seller of the equipment the cash purchase price of $1,137,350. In the other, the shareholder purported to lease the equipment back to the corporation. The sale agreement contained no language of conveyance. Neither the shareholder nor the corporation took any formal steps to consummate the sale. No bill of sale was ever executed, and none of the documents evidencing ownership of the equipment (*e.g.*, files maintained by the corporation on each item of equipment that included the original bill of sale and other pertinent documents) were ever transferred from the corporation to the shareholder. Several

items of equipment were covered by certificates of title issued by the state of Tennessee. None of the title certificates were ever transferred to the shareholder. The corporation remained in possession of all of the equipment.

8. Although the so-called sale agreement recited that the corporation received $1,137,350 in cash, that recitation was false. The shareholder obtained a loan in the amount of $950,000 from one of the defendants, Liberty National Leasing Company (a subsidiary of Liberty National Bank), to finance the major portion of the purchase price and initially only paid this sum to the corporation. Coincidental with this transaction, Nolan transferred the corporation's principal bank accounts from a Nashville bank to one in Mt. Sterling, Kentucky, where Ranier & Associates had its office. Apparently a check in the amount of $1,137,350 was deposited in one of the corporation's newly opened accounts. On the same date, however, a check drawn on that account in the amount of the difference between the Liberty National loan and the purchase price—$187,350—was deposited in one of the shareholder's accounts. These checks apparently were paid on the same date. Thus only $950,000 was actually paid to the corporation in September 1978.

9. Nolan testified at the trial that the $187,350 was withdrawn from the corporation's account in order to safeguard it against a possible unauthorized withdrawal. He indicated that Mr. Fulghum had made such a withdrawal some months before. Mr. Fulghum, however, had been dismissed more than two months earlier. The court thus finds that Nolan's explanation of the withdrawal was patently false. It is apparent that the shareholder had no intention of paying the full cash purchase price in September 1978 but intended only to advance to the corporation the proceeds of the Liberty National loan.

10. A corporate balance sheet prepared by an accounting firm immediately after the September 1978 transaction reflected a shareholder's equity of $170,928.00. Prior

to the purported sale, the equipment was carried on the corporation's books at the depreciated value of $436,258.00. Thereafter, the corporation never represented in its financial records that it continued to own the equipment.

11. While the transaction resulted in an improvement in the corporation's balance sheet and liquidity, it was detrimental to the corporation in that it resulted in a significant taxable gain and necessitated the dissipation of a valuable asset—the tax loss carry-forward—to avoid payment of the substantial tax liability that resulted. The real beneficiary appears to have been the shareholder, which was able to depreciate the equipment from the new, stepped-up basis. While the loan proceeds provided the corporation with additional cash, there was no showing why the corporation itself could not have borrowed this amount of money, using the equipment as collateral as the shareholder did.

12. The shareholder granted Liberty National a security interest in the equipment to secure repayment of this loan. Apparently that security interest was properly perfected, if the shareholder was the owner of the equipment. Appropriate filings were made in the state of Kentucky on the basis that Ranier & Associates was the owner.

13. According to a detailed analysis prepared by Nolan, a substantial number of financial transactions between the corporation and the shareholder took place between June 1978 and November 1979. It was the shareholder's practice to withdraw from the corporation, as well as other corporations it owned, any cash that was not immediately required by the corporation and to return it on an as-needed basis. According to this analysis, which was never seriously questioned by the trustee, there were almost one hundred such transactions during this period of time. Initially the corporation was indebted to the shareholder, but as a result of the $187,350

credit from the equipment transaction, the shareholder became indebted to the corporation and remained so until June 1979. From that time until the corporation ceased doing business in November 1979, the corporation was indebted to the shareholder for advances made to it. The net result is that the corporation presently is indebted to the shareholder in the sum of $387,844.16. Most of the advances made by the shareholder in the latter part of 1979 were in the form of deposits to the corporation's payroll account at the Kentucky bank to ensure completion of jobs in progress.

14. Although there were a substantial number of financial transactions between the shareholder and the corporation, it appears that Nolan, who rigidly controlled the corporation's finances at least after September 1978, maintained detailed records separating the financial affairs of the partnership and the corporation.

15. In May 1979 the shareholder borrowed substantial sums of money from another of the defendants, First Security National Bank of Lexington. As part of the security therefor, Ranier & Associates granted the bank a security interest in the equipment, which also appears to have been properly perfected if the shareholder is the owner of the equipment. It is conceded by the trustee that the sums owed to both secured party defendants substantially exceed the present value of the equipment and that, if their security interests are valid, he has no interest in the equipment.

16. On January 25, 1980, an involuntary petition was filed against the corporation in this court, and an order for relief subsequently was entered.

II. CONCLUSIONS OF LAW

It appears to the court that Texas law is controlling on the issue of whether the shareholder, Ranier & Associates, should be held liable for the debts of the corporation and on the issue of whether there was a valid transfer from the corporation to its sole shareholder.

RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971). The need for certainty, predictability and uniformity of result, and protection of the justified expectations of the parties in most instances, as in the present proceeding, support the application of the local law of the state of incorporation. Comment *c*, RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971). Application of the local law of the state of incorporation is especially appropriate when the issues to be resolved relate to a corporation's relationship to its shareholders, directors, and officers. Comment *b*, RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

A. *Disregard of the Corporate Entity*

The law of Texas is quite clear that the corporate entity will be disregarded only as an extraordinary means of relief when the corporate fiction has been employed to defraud existing creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate a monopoly, or to protect the commission of crimes. *Pace Corp. v. Jackson*, 155 Tex. 179, 284 S.W.2d 340 (1955); *Roylex, Inc. v. Langson Bros. Construction Co.*, 585 S.W.2d 768 (Tex. Civ. App. 1979); *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. 1979); *Tigrett v. Pointer*, 580 S.W.2d 375 (Tex. Civ. App. 1978); *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App. 1978); *Holmes v. Clow*, 533 S.W.2d 99 (Tex. Civ. App. 1976); *Minchen v. Van Trease*, 425 S.W.2d 435 (Tex. Civ. App. 1968); *Radio KBUY, Inc. v. Lieurance*, 390 S.W.2d 16 (Tex. Civ. App. 1965). To disregard the corporate fiction in less extraordinary circumstances

> would erode the concept of a corporation as a separate legal entity, apart from its shareholders, directors, and officers. Corporations would then become meaningless.

Angus v. Air Coils, Inc., 567 S.W.2d 931 (Tex. Civ. App. 1978).

The Texas courts have developed two conjunctive prerequisites to relief in the form of disregarding the corporate entity. First, the complaining party must demonstrate fraud and a lack of good faith on the part of the controlling stockholder. *Roylex, Inc. v. Langson Bros. Construction Co.*, 585 S.W.2d 768 (Tex. Civ. App. 1979); *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. 1979); *Hanson Southwest Corp. v. Dal-Mac Construction Co.*, 554 S.W.2d 712, 716 (Tex. Civ. App. 1977); *Holmes v. Clow*, 533 S.W.2d 99 (Tex. Civ. App. 1976); *Radio KBUY, Inc. v. Lieurance*, 390 S.W.2d 16 (Tex. Civ. App. 1965); *see Arnold v. Phillips (In re Southern Brewing Co.)*, 117 F.2d 497 (5th Cir.), *cert. denied*, 313 U.S. 583, 61 S. Ct. 1102, 85 L. Ed.2d 1539 (1941); *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336 (Tex. 1968); *Peace Corp. v. Jackson*, 155 Tex. 179, 284 S.W.2d 340 (1955). One of the indicia of fraud and bad faith is capitalization that is very small in relation to the nature of the corporation's business and to the risks that the business necessarily entails. *See, e.g., Arnold v. Phillips (In re Southern Brewing Co.)*, 117 F.2d 497 (5th Cir.), *cert. denied*, 313 U.S. 583, 61 S. Ct. 1102, 85 L. Ed.2d 1539 (1941); *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336 (Tex. 1968); *Moore & Moore Drilling Co. v. White*, 345 S.W.2d 550 (Tex. Civ. App. 1961). The question of inadequate capitalization, however, is determined as of the time of incorporation, and subsequent events such as the failure of the corporation cannot afford the basis of a finding of fraud or bad faith at the inception of the corporation. *Moore & Moore Drilling Co. v. White*, 345 S.W.2d 550 (Tex. Civ. App. 1961); Hamilton, *The Corporate Entity*, 99 TEX. L. REV. 979, 986 (1971); *see Arnold v. Phillips (In re Southern Brewing Co.)*, 117 F.2d 497 (5th Cir.), *cert. denied*, 313 U.S. 583, 61 S. Ct. 1102, 85 L. Ed.2d 1539 (1941).

Second, the Texas courts require a showing of such a degree of stockholder control that the corporation retains

no separate corporate interests of its own. *See Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. 1978); *Hanson Southwest Corp. v. Dal-Mac Construction Co.*, 554 S.W.2d 712 (Tex. Civ. App. 1977); *Simon v. Estate of Allen*, 497 S.W.2d (Tex. Civ. App. 1973), *cert. denied*, 419 U.S. 843, 95 S. Ct. 76, 41 L. Ed.2d 71 (1974). This requirement conforms with the instrumentality theory that is applied under general corporation law:

> [T]he control required for liability under the "instrumentality" rule amounts to total domination of the subservient corporation, to the extent that the subservient corporation manifests no separate corporate interests of its own and functions solely to achieve the purposes of the dominant corporation. As Professor Fletcher states:
>
> > The control necessary to invoke what is sometimes called the "instrumentality rule" is not mere majority or complete stock control but such domination of finances, policies and practices that the controlled corporation has, so to speak, no separate mind, will or existence of its own and is but a business conduit for its principal.
>
> 1 W. Fletcher, [Cyclopedia of the Law of Private Corporations], § 43 at 204-205.

Krivo Industrial Supply Co. v. National Distillers & Chemical Corp., 483 F.2d 1098, 1106 (5th Cir. 1973) (applying Alabama law). The Texas Supreme Court has held that the fact that a corporation owns all or the majority of the stock in another corporation does not destroy the indentity of the latter as a distinct legal entity; neither does the fact that the stockholders or officers in the two corporations may be the same, nor does the fact that one corporation exercises a controlling influence over the other. *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336 (Tex. 1968); *accord, Arnold v. Phillips, (In re Southern Brewing Co.)*, 117 F.2d 497 (5th Cir.),

cert. denied, 313 U.S. 593, 61 S. Ct. 1102, 85 L. Ed.2d 1539 (1941); *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App. 1978); *Sutton v. Reagen & Gee*, 405 S.W.2d 828 (Tex. Civ. App. 1966). Texas courts emphasize that a failure to follow corporate formalities may warrant disregarding the corporate fiction for the purpose of imposing stockholder liability. *Roylex, Inc. v. Langson Bros. Construction Co.*, 585 S.W.2d 768 (Tex. Civ. App. 1979); Hamilton, *supra*, 49 TEX. L. REV. at 989-92. Factors that may warrant ignoring the separate corporate existence include:

(1) comencement of business without the issuance of shares;

(2) lack of shareholder or directors' meetings or of the signing of consents;

(3) the making of decisions by shareholders as if they were partners;

(4) a failure to distinguish between corporate property and personal property;

(5) the use of corporate funds to pay personal expenses without proper accounting; and

(6) a failure to maintain complete and separate corporate and financial records.

Roylex, Inc. v. Langson Bros. Construction Co., 585 S.W. 2d 768, 772 (Tex. Civ. App. 1979); Hamilton, *supra*, 49 TEX. L. REV. at 990. Evidence of informality or a commingling of shareholder and corporate affairs, however, alone is insufficient to justify disregarding the corporate entity in the absence of bad faith on the part of the controlling shareholder or prejudice to third parties. In a contractual context, the Texas Supreme Court in *Bell Oil* held that to disregard the corporate fiction,

> the corporate arrangement must be one which is likely to be employed in achieving an inequitable re-

> sult by bringing into operation a basically unfair device which in all probability will result in prejudice to those dealing with one or more of the units making up the corporate arrangement, or one which has actually resulted in the complaining party's having been placed in a position of disadvantage by the exercise of inequitable means, of which the corporate arrangement is a part.

431 S.W.2d at 340. There must be a showing that the individual who controls the corporation and manages its business affairs does so in such a manner that individual or corporate creditors may be deprived of their legal rights by a shuffling of the legal personalities of the corporation and its controller to the extent that the corporation is, in fact, the alter ego of the controller or that the corporate fomalities were not adhered to by the corporation in connection with the matters in question. *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. 1979). It likewise is clear that unity of financial interest alone does not justify disregarding the corporate entity. *Angus v. Air Coils, Inc.*, 567 S.W.2d 931 (Tex. Civ. App. 1978); *Hanson Southwest Corp. v. Del-Mac Construction Co.*, 554 S.W.2d 712 (Tex. Cir. App. 1977). The fact that the controlling shareholder puts money into the corporation, presumably to keep it solvent, is not the kind of evidence that justifies piercing the corporate veil. *Angus v. Air Coils, Inc.*, 567 S.W.2d 931, 933 (Tex. Civ. App. 1978). There must be

> some ground in addition to mere unity of financial interest, ownership, and control for a court to treat [the corporation and the controlling stockholder] as one in law . . . . That additional ground turns on whether there was good faith and honesty in the use of a subsidiary corporate entity for legitimate ends. Generally, it is determined by whether the subsidiary corporate entity is so controlled and manipulated by

> the parent for the parent's own interests that it prejudices innocent third parties or is in contravention of the public welfare.

Hanson Southwest Corp. v. Dal-Mac Construction Co., 554 S.W.2d 712, 716 (Tex. Civ. App. 1977) (citations omitted).

The court concludes that the Texas courts would find disregarding the corporate entity to be an inappropriate form of relief under the facts presented in this proceeding. Texas law requires a showing of both fraud and complete control by the controlling party solely for its own purposes. The trustee failed to allege in his complaint and failed to put on any proof at the trial of this matter that Ranier & Associates used the corporate entity of Fulghum Construction Corporation to defraud any third parties. None of the parties to this proceeding deny that Fulghum was acutely underfinanced at all times after Ranier & Associates purchased all of the corporation's stock in 1977. Texas law requires, however, that the sufficiency of capitalization as an indicia of fraud be resolved as of the time of incorporation.

In addition, the trustee has failed to show that the control exercised over Fulghum by Ranier & Associates was so complete that the corporation retained no separate corporate interests of its own but rather existed solely for Ranier & Associates' purposes. All of the proof indicates that all of the funds advanced to Fulghum in whatever form during 1978 and 1979 were intended to rehabilitate the company and to keep it solvent. As the Texas court in *Angus v. Air Coil, Inc.*, 567 S.W.2d 931, 933 (Tex. Civ. App. 1978), concluded, such evidence alone does not justify disregarding the corporate veil. The actions taken by Ranier & Associates after their purchase of Fulghum in 1977—the termination of the company's old management and the hiring of a new executive vice-president, the exercise by Nolan of complete control over the company's financial affairs, the transfer of the company's

bank accounts to the Mt. Sterling bank, and the advances by Ranier & Associates during 1979 to meet Fulghum's payroll—are more indicative of an intent on the part of Ranier & Associates to rehabilitate the company than an intent by the shareholder to use the corporate shell for its own purposes. Even were the court to disregard the fact that separate corporate and financial records were maintained and the absence of any proof that Ranier & Associates used Fulghum funds to pay for their own expenses without proper accounting and conclude that Ranier & Associates exercised complete control over Fulghum, Texas law requires more as a justification for disregarding the corporate fiction. That additional ground, as the Texas court observed in *Hanson Southwest Corp. v. Dal-Mac Construction Co.*, 554 S.W.2d 712, 716 (Tex. Civ. App. 1977), "turns on whether there was good faith and honesty in the use of a subsidiary corporate entity for legitimate ends." The court cannot conclude from the proof submitted to it in this proceeding that the trustee has established that Ranier & Associates ever exercised control over Fulghum in bad faith or for other than legitimate purposes. There is no basis for imposing liability on the shareholder for the Corporation's debts.

B. *Validity of the Equipment Transfer*

Although Fulghum never transferred to Ranier & Associates either the certificates of title or any of the other documents indicating ownership of the equipment, the failure to do so is not fatal to the positions asserted by the shareholder and the two secured party defendants. The Uniform Commercial Code (the pertinent provisions of which are identical in each of the other states whose law might be controlling, Tennessee and Kentucky) substantially curtails the significance of title in the determination of the rights of parties relative to a sale of goods. *In re Overbrook & Barson's Inc.*, 5 U.C.C. REP. SERV. 546, 552 (Bankr. Ct. E.D. Pa. 1968); *William F. Wilke, Inc. v. Cummins Diesel Engines, Inc.*, 252 Md. 61.1, 250

A.2d 886, 6 U.C.C. REP. SERV. 45 (1969); *Sheeskin v. Giant Food, Inc.*, 20 Md. App. 611, 318 A.2d 874, 14 U.C.C. REP. SERV. 892 (Ct. Spec. App. 1974, *aff'd sub mon. Giant Food, Inc. v. Washington Coca-Cola Co. Bottling Co.*, 273 Md. 592, 332 A.2d 1 (1975). Under § 2-1006 of the Uniform Code, however, a sale under Article 2 consists of "the passing of title from the seller to the buyer for a price." The concept of title under the Code is governed by § 2-401. Section 2-401 provides that in the determination of the rights of parties relative to a sale of goods, Article 2 applies irrespective of title to the goods except when the pertinent section refers to such title. To the extent that specific provisions in the Code do refer to title, section 2-401 provides specific rules to be applied. Section 2-401(1) provides that any retention or reservation by the seller of the title in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Section 2-401(3)(b) provides that unless otherwise explicitly agreed when delivery is to be made without moving the goods, title passes at the time and place of contracting if the goods already are identified at the time of contracting and if no documents of title are to be delivered.[1] Section 2-501(1)(b) provides that in the absence of explicit agreement, identification occurs when goods are shipped, marked, or otherwise designated by the seller as goods to which the contract refers.

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[1] Automobile certificates of title are not considered documents of title as that term is used in the Uniform Commercial Code, and nondelivery of a certificate of title at the time of a sale does not prevent the passage of title from the seller to the buyer under § 2-401. *National Exchange Bank v. Mann*, 81 Wis.2d 352, 260 N.W.2d 716, 23 U.C.C. REP. SERV. 510, 514 (1978); *Wood Chevrolet Co. v. Bank of Southeast*, —— Ala. ——, 352 So.2d 1350, 23 U.C.C. REP. SERV. 290, 292 (1977); *National Mutual Ins. Co. v. Hayes*, 276 N.C. 620, 174 S.W.2d 511, 7 U.C.C. REP. SERV. 1105, 1112 (1970); *Medico Leasing Co. v. Smith*, 457 P.2d 548, 6 U.C.C. REP. SERV. 786, 790 (Okla. 1969).

In *Ace Supply, Inc. v. Rocky-Mountain Machinery Co.*, 525 P.2d 965, 15 U.C.C. Rep. Serv. 324 (Idaho 1974), Bannock, a dealer in farm equipment, was indebted to Ace Supply in an amount in excess of $4,000. Bannock agreed to sell Ace a tractor, the consideration for which was to be the cancellation of Bannock's indebtedness to Ace. It was agreed that the tractor was to remain on Bannock's premises until needed by Ace and that during that time, Bannock was to have the right to sell the tractor for a sum in excess of $4,000 and retain all proceeds above that amount. Bannock subsequently asserted that the agreement that had been executed by the parties constituted only an executory contract or merely a contract to sell goods at a future time. The Idaho court disagreed and held that the written agreement was

> clearly adequate as a contract of sale when measured against the requirements of the Uniform Commercial Code. It contains the date, identifies the buyer and the seller and specifies exactly the model, make and serial number of the tractor, lists the amount and nature of the consideration and is signed by an agent of each corporation.

15 U.C.C. Rep. Serv. at 327.

In *Southwest Bank of Omaha v. Maritz*, 203 Neb. 45, 26 U.C.C. Rep. Serv. 231 (1979), Rumbaugh, the owner of a hardware store, transferred to a corporation of which he was the sole stockholder certain of the store's fixtures and inventory in exchange for stock in the corporation. The minutes of the corporation's first stockholder meeting recited the transfer, and Rumbaugh testified that he had intended the corporation to become the owner of the property transferred. After finding that no physical delivery had been necessary and that the contract, which consisted of conduct by both parties that recognized the existence of a contract under § 2-207(3), had not contemplated the delivery of any documents of title, the Nebraska court concluded that, under § 2-401

(3)(b), title to the property passed at the time of the contracting. 26 U.C.C. REP. SERV. at 237.

Section 2-401(3)(b) is applicable to the September 1978 equipment transaction. A fair reading of both of the agreements indicates that a sale of the equipment to Ranier & Associates was contemplated without moving the equipment. Title to the equipment, therefore, to the extent of the consideration paid therefor passed at the time and place of contracting.

A portion of the stated consideration, however, was not paid at that time. It was withdrawn and deposited in Ranier & Associate's account. To the extent, therefore, that Fulghum retained title to the equipment, it did so only to secure payment of the balance of the purchase price. According to Nolan's analysis of the financial transactions between Fulghum and Ranier & Associates, this has occurred and accordingly the corporation no longer has any interest in the equipment.

The case that is most analogous to the facts before the court is *Young v. Golden State Bank,* 560 P.2d 855, 21 U.C.C. REP. 922 (Colo. App. 1977). There a sale of a business had not been consummated in that no bill of sale was executed. The court held that there was intent to sell and that the failure to deliver a bill of sale was at most a reservation of title that acted as a reservation of a security interest to secure payment of the balance of the purchase price. Security interests in the assets of the business that had been granted to third parties by the new owner were held to be valid.

The trustee has complained that the sale was not authorized by formal corporate action. It is apparent, however, that such was not necessary, since the sale was to the sole shareholder.[2] In addition, Nolan had previously been given ample authority to effect such a sale.

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[2] Under the Texas Business Corporation Act, a sale, lease, exchange, or other disposition of all or substantially all of a corpora-

The court is well aware of the general rule that contracts between a corporation and a majority stockholder are to be scrutinized with much greater care than those made with third parties. 13 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5834 (rev. ed. 1970). The court also is aware that in a sale of corporate property, if the purchaser of the property is in effect the seller, as when the purchasing corporation is owned entirely by a majority stockholder in the selling corporation, the transaction will be subject to the closest of scrutiny. 13 FLETCHER, PRIVATE CORPORATIONS, *supra*, at § 5837. The purpose for these general rules, however, is to afford protection to the minority stockholders of the selling corporation. *See, e.g., Wheeler v. Abilene Nat'l*

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tion's property and assets may be authorized by an affirmative vote of two-thirds of the corporation's stockholders at an annual or special meeting. *Vermilion Parish Peat Co. v. Green Belt Peat Moss Co.*, 465 S.W.2d 950 (Tex. Civ. App. 1971); TEX. BUS. CORP. ACT art. 5.10 (Vernon 1980). No such meeting of stockholders was held and no formal stockholder authorization for the transfer was obtained prior to the transaction of September 20. The court has not located any Texas decisions that address the effect of noncompliance with article 5.10 when all of a corporation's stock is owned by a single stockholder. The purpose for such consent statutes is to protect the corporation's stockholders. *Fishkin v. Hi-Acres, Inc.*, 462 Pa. 309, 341 A.2d 95 (1975); *Still v. Travelers Indemnity Co.*, 374 S.W.2d 95 (Mo. 1963); 6A FLETCHER, PRIVATE CORPORATIONS, *supra*, at § 2949.2. Accordingly, it has been held that the sale of all or substantially all of a corporation's assets without the affirmative vote of the requisite percentage of stockholders at a meeting called for that purpose as required by statute is valid when all of the grantor corporation's stock is owned by a single stockholder. *Southmoor, Inc. v. Baptist Memorial Hospital*, 60 Tenn. App. 148, 444 S.W.2d 716 (1969); *see* 6A FLETCHER, PRIVATE CORPORATIONS, *supra*, at § 2949.2 n.51. This court is of the opinion, therefore, that the Texas courts would reach a similar conclusion under the facts present in this proceeding, based upon the established rule in that jurisdiction that when all of a corporation's stockholders act together on behalf of the corporation, their action is substantially corporate action even in the absence of formal meetings or formal votes. *Sutton v. Reagan & Gee*, 504 S.W.2d 828, 836 (Tex. Civ. App. 1966).

Bank Bldg. Co., 159 F. 391, 393-95 (8th Cir. 1908). In theory, the majority stockholder who sells corporate property owes a fiduciary duty to the minority stockholders to obtain the highest possible price for the property sold and to account for and pay over to the minority their just proportion of the proceeds from the sale. *Wheeler v. Abilene Nat'l Bank Bldg. Co.*, 159 F. at 394. When all of the stock in the selling corporation is owned by a single stockholder, an application of these general rules would not serve the purpose for which they were intended.

The trustee next insists that if there was a conveyance, it was fraudulent and should be set aside. A fraudulent conveyance under Texas law is a transfer made by a debtor with the intent to hinder, delay, or defraud his creditors by placing his property beyond the reach of creditors. *Nobles v. Marcus*, 533 S.W.2d 923, 925 (Tex. 1976); *see* TEX. BUS & COM. CODE ANN. § 24.02 (Vernon 1968). Ordinarily, the Texas statute of fraudulent conveyances does not apply to those who become creditors subsequent to the conveyance claimed to be fraudulent unless the debtor's intent at the time of the conveyance was to shield the property from debts thereafter to be incurred. *Cole v. Terrell*, 71 Tex. 549, 9 S.W. 668 (1888); *Cates v. Clark*, 24 S.W.2d 450 (Tex. Civ. App. 1930). It is clear, however, that a trustee in bankruptcy may attack a fraudulent transfer under the Texas statute. *United Towing Co. v. Phillips*, 242 F.2d 627 (5th Cir.), *cert. denied*, 355 U.S. 861, 78 S. Ct. 93, 2 L. Ed.2d 68 (1957). *See also Mann v. Shepard (In re Gervich)*, 570 F.2d 247, 253 (8th Cir. 1978). The settled rule in Texas is that a contract between a corporation and one or all of its officers and directors is not void per se, but may be avoided for unfairness or fraud. *Zorn v. Brooks*, 125 Tex. 614, 83 S.W.2d 949, 951 (1935). The rule relating to contracts between a corporation and its officers and directors likewise is applicable to contracts between a corporation and its majority

stockholders, so that such contracts are at most voidable rather than void. 13 FLETCHER, PRIVATE CORPORATIONS, *supra*, at § 5781 n.14.

Assuming that the conveyance was fraudulent, therefore, the principal difficulty with the trustee's position is that such conveyances are merely voidable. The transferee may make valid further conveyances to innocent third parties before the fraudulent conveyance is set aside. *See* TEX. BUS. & COM. CODE ANN. § 24.02(b) (Vernon 1968); 37 AM. JUR.2d *Fraudulent Conveyances* § 121 (1968).

Although both of the secured party defendants were careless in their handling of the documentation of their security interests, there has been no showing that either was aware of an irregularity in the sale-leaseback transaction, much less that it might be fraudulent as to the corporation. Thus the grant to them of security interests in the equipment by Ranier & Associates was valid, and, since their debt far exceeds the value of the equipment, it is apparent that the trustee has no interest in the same.

In addition, although the conveyance obviously was more beneficial to Ranier & Associates than to Fulghum the court cannot conclude that it was fraudulent. The appraised value of the equipment was paid.

Although the foregoing does not dispose of all of the issues raised by the various pleadings, it does dispose of all issues that touch on the rights of the parties to the equipment which has been tied up by this litigation for some months. An appropriate partial judgment will be entered recognizing that the trustee has no interest in the equipment. All other issues will continue under advisement.

/s/ Russell H. Hippe, Jr.
RUSSELL H. HIPPE, JR.
Bankruptcy Judge

xc: July 14, 1980
Nashville, Tennessee

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE

Case No. 380-00235

Adv. Proc. No. 380-0081

IN RE: FULGHUM CONSTRUCTION COMPANY,
Debtor

ROBERT H. WALDSCHMIDT, TRUSTEE,
Plaintiff

vs.

HARRY H. RANIER, ALGIN H. NOLAN,
RANIER & ASSOCIATES, EGAN IRON WORKS,
FIRST SECURITY NATIONAL BANK OF LEXINGTON,
and LIBERTY NATIONAL LEASING COMPANY,
Defendants

PARTIAL JUDGMENT

In accordance with the Memorandum entered contemporaneously herewith,

It is ORDERED, ADJUDGED AND DECREED that the trustee has no interest in the equipment which is the subject of the complaint and the stay of 11 U.S.C. § 362(a) is hereby lifted and the preliminary injunction dissolved and immediate possession of said equipment awarded to the defendants; and

It is further ORDERED that the court shall continue under advisement all other issues raised by the pleadings.

Dated this 14th day of July, 1980.

/s/ Russell H. Hippe, Jr.
RUSSELL H. HIPPE, JR.
Bankruptcy Judge

xc: Robert H. Waldschmidt, Esq.
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Egan Iron Works